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SUBJECT: SERBIA: ALMOST A DONE DEAL - TADIC AND MEDVEDEV TO SIGN
ENERGY CONTRACTS ON DECEMBER 24

Ref: a) Belgrade 1243

b) Belgrade 1222

SUMMARY

1. The Serbian government announced that on December 24 in Moscow, a Serbian delegation headed by President Boris Tadic and Russian President Dmitry Medvedev would officially sign three separate contracts to sell Serbian state owned oil company NIS to Russian Gazprom, construct the South Stream pipeline through Serbia, and build a gas storage facility in Banatski Dvor. In addition to the three contracts, Tadic and Medvedev would also sign a political agreement that would guarantee that Russia implements all three contracts. Although the energy deal offers few economic benefits for Serbia, it has been widely hailed as vital to Serbia's geo-strategic position in Europe. End Summary.

TO BE SIGNED, SEALED AND DELIVERED ON DECEMBER 24

2. The Serbian government announced that on December 24 in Moscow, Russian president Dmitry Medvedev and Serbian president Boris Tadic would sign the energy deal that will sell 51% of Serbian state oil company NIS to Russian Gazprom. Dusan Bajatovic, Director of state-owned gas company Srbijagas and Alexei Miller, CEO of Russian Gazprom are to sign two separate contracts envisaging the construction of the South Stream gas pipeline through Serbia and the underground gas storage Banatski Dvor. (Note: In the December 23 edition of popular daily Blic, Miller was named the most influential foreigner in Serbia. End Note.) The sale of NIS will not be linked to or contingent upon the construction of the pipeline or gas storage facility. Tadic and Medvedev are to also sign a political agreement that will guarantee that all three contracts will be implemented. Content of the political agreement was not released. The Serbian government approved all three contracts via a telephone session with ministers on December 23.

THE DEVIL IS IN THE DETAILS

3. Gazprom will pay \$555 million for the major stake in NIS plus a minimum investment of \$760 million in the company by 2012. Serbia will keep 49% of the company, out of which 19.4% will be distributed as free shares to citizens and NIS workers. Gazprom will have the director and president of the managing board positions, as well as a majority of the seats on the managing board. Serbia will hold the president of the monitoring board position and have the majority of seats on a monitoring board.

4. Gazprom is expected to invest \$760 million through soft loans to NIS. NIS will repay the loan at Euro Libor plus 2% interest rate within 10 years, beginning 2012. No collateral for the loan will be required. About \$677 million of the investment will go to modernizing refineries to double the current 4 million tons per year

capacity by 2012 and to bring oil quality up to European standards. The remaining \$83 million will go to environmental clean up. In a conversation with us on December 23, NIS Director and member of the energy deal negotiating team Milos Saramandic said in addition to loans from Gazprom, NIS would take out \$1 billion in commercial loans to help develop the company. Serbia will also provide property transfer and environmental damage guarantees to Gazprom. NIS' oil importing monopoly position is to end in 2010, as outlined in the Central European Free Trade Agreement. If Gazprom fails to implement the investment plan, the sale of NIS could be cancelled.

SOCIAL PROGRAM: NO LAYOFFS, COST OF LIVING INCREASES

15. The NIS contract also includes a social program hammered out by NIS management and the company's trade union which the NIS Managing Board approved in June 2008. There is to be no worker lay-offs before 2012 and each redundant worker who leaves voluntarily is to receive \$1,040 for each year of employment. The program also envisages salary increases in line with the cost of living. Gazprom's failure to adhere to the social program could also terminate the sale of NIS.

COMMENT

16. Despite the dearth of evidence that the energy deal will benefit Serbia and the apparent secrecy of the "political guarantees" from Russia, Tadic continues to hail the deal as the best agreement in decades for Serbia. Tadic and the media have waxed nostalgic of Serbia's Tito-era influence in the world with notions that the NIS-Gazprom union ensured Serbia's geo-strategic position in Europe. However, many aspects of the deal are still unclear and

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deliberately unaddressed. What is evident, however, is that Serbia thinks it can play the game of balancing its international interests between East and West. End Comment.

MUNTER